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EFFECTS OF CREDIT MANAGEMENT PRACTICES ON PROFITABILITY OF TELECOMMUNICATION COMPANIES IN GAROWE, SOMALIA

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Abstract: *Sound credit management is a prerequisite for every industry's stability and continuing profitability, while deteriorating credit quality is the most frequent cause of poor financial performance and condition. Weak credit risk management is the primary cause of many enterprises' failures. Mc Menamin (1999). And Hempel et. al (1994) carried out studies of national banks that failed in the mid-1980s in the U.S.A and found out that the consistent element in the failures was the inadequacy of the bank's credit risk management system in the controlling of loan quality. Therefore, this study intended to undertake analysis on the effects of credit management on profitability of Telecommunication companies in Garowe, Somalia. The main objective of the study was to evaluate the effects of credit management practices on profitability of the telecommunication companies in Garowe, Puntland, Somalia. The researcher set out to establish the effect of client appraisal, credit risk control and collection policy on profitability of telecommunication companies in Garowe. The study found out that client appraisal and credit risk control play a major role for profitability of the companies, it also realized that companies formulated and use collection policies which also has positive relationship with profitability of the telecommunication companies in Garowe, Somalia. The study purposes companies to soften their strict policies for client assessments and collection of credit to ensure future loyalty of the customers and line authorities of the government also should supervise and formulate policies on credit management practices of the telecommunication companies in Garowe, Puntland.*

Keywords: *Credit appraisal, Credit Management, Profitability, Telecommunication*

Background of the Study

Credit is one of the many factors that can be used by a firm to influence demand for its products. According to Horne and Wachowicz (1998), firms can only benefit from credit if the profitability generated from increased sales exceeds the added costs of receivables. Myers and Brealey (2003) define credit as a process whereby possession of goods or services is allowed without spot payment upon a contractual agreement for later payment.

Business enterprises today use trade credit as a prominent strategy in marketing and financial management. Thus, trade credit is necessary in the growth of the businesses.

When a firm sells its products or services and does not receive cash for it, the firm is said to have granted trade credit to its customers. Trade credit thus creates accounts receivables which the firm is expected to collect in future (Kungu, Wanjau, Waititu & Gekara, 2014). Accounts receivables are executed by generating an invoice which is delivered to the customer, who in turn must pay within and with the agreed terms. The accounts receivables are one of the largest assets of a business enterprise comprising approximately 15% to 20% of the total assets of a typical manufacturing firm (Dunn, 2009). Investment in receivables takes a big chunk of organization's assets. These assets are highly vulnerable to bad debts and losses. It is therefore necessary to manage accounts receivables appropriately.

Trade credit is very important to a firm because it helps to protect its sales from being eroded by Competitors and attracts potential customers to buy at favourable terms. If there is competition in the industry, selling on credit becomes inevitable. A business will lose its customers to competitors if it does not extend credit to them. Thus, investment in accounts receivables may not be a matter of choice but a matter of survival (Kakuru, 2001). Given that investment in receivables has both benefits and costs; it becomes important to have such a level of investment in receivables at the same time observing the twin objectives of liquidity and profitability.

To remain profitable, businesses must ensure proper management of their receivables (Foulks, 2005). The management of receivables is a practical problem, businesses can find their liquidity under considerable strain if the levels of their accounts receivables are not properly regulated (Samuels & walkers, 1993). Thus, management of accounts receivables is important, for without it; receivables will build up to excessive levels leading to declining cash flows. Poor management of receivables will definitely result into bad debts which lowers the business‟ profitability.

The growth in economic activities as currently witnessed in Nigeria; in our present democratic government with its attendant limited financial resources available to the operators of the market has no doubt brought about increase in credit transaction (Ifurueze, 2013). The impact depends on the skill and prowess with which the companies manage their credit sales.

Beckan and Richard (1984) have seen that most companies after granting credit sales rely on them as assets without providing adequately for possible. With this situation, the financial statements of such companies obviously will lack true and fair view because the amount of trade debtors cannot be fully realized.

Credit management is one of the most important activities in any company and cannot be overlooked by any economic enterprise engaged in credit irrespective of its business nature. It is the process to ensure that customers will pay for the products delivered or the services rendered. Myers and Brealey (2003) describe credit management as methods and strategies adopted by a firm to ensure that they maintain an optimal level of credit and its effective management. It is an aspect of financial management involving credit analysis, credit rating, credit classification and credit reporting.

Nelson (2002) views credit management as simply how an entity manages its credit sales. It is a prerequisite for any entity dealing with credit transactions since it is impossible to have a zero credit or default risk.

The higher the amount of accounts receivables and their age, the higher the finance costs incurred to maintain them. If these receivables are not collectible on time and urgent cash needs arise, a firm may result to borrowing and the opportunity cost is the interest expense paid.

Credit management starts with the sale and does not stop until the full and final payment has been received. It is as important as part of the deal as closing the sale. In fact, a sale is technically not a sale until the money has been collected. It follows that principles of goods lending shall be concerned with ensuring, so far as possible that the borrower will be able to make scheduled payments with interest in full and within the required time otherwise, the profit from an interest earned is reduced or even wiped out by the bad debt when the customer eventually defaults. Credit management is concerned primarily with managing debtors and financing debts. The objectives of credit management can be stated as safeguarding the companies‟ investments in debtors and

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optimizing operational cash flows. Policies and procedures must be applied for granting credit to customers, collecting payment and limiting the risk of non-payments.

Statement of the Problem

Sound credit management is a prerequisite for every industry's stability and continuing profitability, while deteriorating credit quality is the most frequent cause of poor financial performance and condition. According to Gitman (1997), the probability of bad debts increases as credit standards are relaxed. Firms must therefore ensure that the management of receivables is efficient and effective .Such delays on collecting cash from debtors as they fall due has serious financial problems, increased bad debts and affects customer relations.

Weak credit risk management is the primary cause of many enterprises' failures. Mc Menamin (1999). And Hempel et. al (1994) carried out studies of national banks that failed in the mid-1980s in the U.S.A and found out that the consistent element in the failures was the inadequacy of the bank's credit risk management system in the controlling of loan quality.

Yakup and Asli (2010) point out in their study that over the last decade the business environment has become more and more global, which has not only enabled companies to gain access to new customers and to additional resource but also forced companies to cope with increased level of international competition and a growing diversity of international business risks as risks of fluctuating currencies, commodity prices and interest rates.

However, whether private companies implement systems of credit management or not and how these systems help their profitability is not clear and there are no similar researches undertaken so far to cope up with these problems.

Therefore, this study intends to undertake analysis on the effects of credit management on profitability of Telecommunication companies in Garowe, Somalia.

Objectives of the study

1. To establish the effect of client appraisal on profitability in Telecommunication Companies
2. To determine the effect of credit risk control on profitability in Telecommunication Companies
3. To find out the effect of collection policy on profitability in Telecommunication Companies.

Conceptual framework

Independent variables **Dependent Variable**

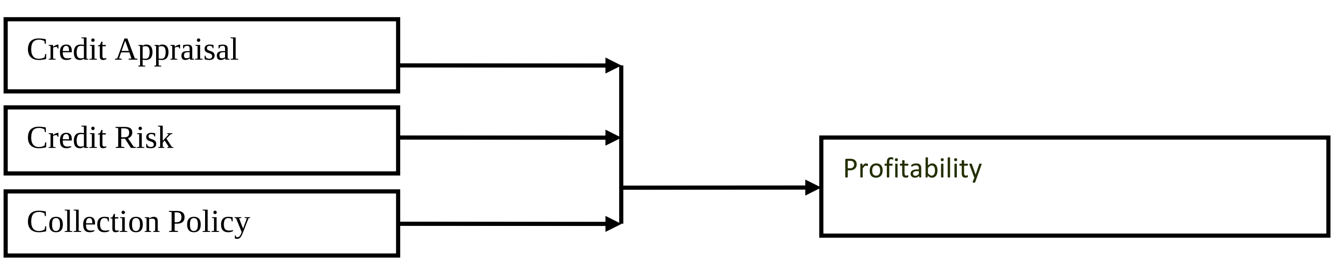

Figure 1: Conceptual Framework

Research Methodology

This study used descriptive cross-sectional research design. The target population of this study was the staff from credit department of all the telecommunication companies in Garowe. The departments have a total of 57 members of staff according to their human resource managers. Since the population of this study are small (57), there was no need of determining sample size order to achieve accuracy. Instead the entire population was considered as the sample size because it was possible to collect data from the whole population. Questionnaires were administered to the company credit staff through drop and pick method. This method was selected because it doesn't inconvenience the respondents since they could answer the questions during their free time. The data collected through questionnaires was tabulated and analyzed using the Statistical Package for the Social Sciences (SPSS) software package.

Results and Discussions

Influence of Client appraisal practices on the Profitability of telecommunication Companies in Garowe, Somalia

This objective sought to determine Influence of Client appraisal practices on the profitability of telecommunication companies in Garowe, Somalia. Based on a five-point Likert scale (Strongly Disagree, Disagree, Neutral, Agree, and Strongly Agree), respondents were presented with several of items to measure the extent to which Client appraisal practices on the profitability of telecommunication companies in Garowe, Somalia. Table 1 shows the influence of Client appraisal practices on the profitability of telecommunication companies in Garowe, Somalia.

Table 1: Influence of Client appraisal practices on the profitability of Telecommunication Companies in Garowe, Somalia

Indicator	**Mean**
Client appraisal practices	
Client assessment is a viable strategy for credit management	3.71
The company has skilled & competent personnel for carrying out client appraisal	4.29
Client appraisal considers the character of the customers seeking credit facilities.	4.67
Collateral is greatly considered while evaluating clients.	3.9
Loan defaults are caused by failure to assess customer's capacity to post pay the bills.	3.72
Average Mean	4.05

The table 1 showed that the mean of the Client assessment is a viable strategy for credit management is (3.71 good), which indicates that most of the respondents agreed that the telecommunication companies appraise their clients before they give credit. The top and middle managers of the credit departments do this to reduce the credit risk. The table also indicated that the mean of the company has skilled & competent personnel for carrying out client appraisal is (4.29 very good) which means that majority of the respondents agreed that the telecommunication companies have skilled staff to do this job. The table also exposed that the mean of that Client appraisal considers the character of the customers seeking credit facilities is (4.67 very good). The table also showed that the mean of that Collateral is greatly considered while evaluating clients is (3.9 good), which represents that the respondents agreed that the telecommunication industries always use collateral as way of credit management. The table again indicated that the mean of that Loan defaults are caused by failure to assess customer's capacity to post pay the bills which is (3.72 good), this implies that the majority of the respondents agreed that the failure to assess the customer capacity will cause loan defaults.

The first step in limiting credit risk involves screening clients to ensure that they have the willingness and ability to repay a loan. Microfinance Institutions use the 5Cs model of credit to evaluate a customer as a potential borrower (Abedi, 2000). The 5Cs help MFIs to increase loan performance, as they get to know their customers better. These 5Cs are: character, capacity, collateral, capital and condition. However, all these are not applied in telecommunication companies in Garowe, Somalia. When assessing clients whether to allow post payment of bills or not.

Influence of Credit Risk Controls Practices on the Profitability of Telecommunication Companies in Garowe, Somalia

This objective sought to assess the influence of Credit Risk Controls practices on the profitability of telecommunication companies in Garowe, Somalia. Based on a five-point Likert scale (Strongly Disagree, Disagree, Neutral, Agree, and Strongly Agree), respondents were presented with several of items to measure the extent to which Credit Risk Controls practices effects the growth of financial institutions in Garowe Puntland. Table 2 shows Influence of Credit Risk Controls practices on the profitability of telecommunication companies in Garowe, Somalia.

Table 2: Influence of Credit Risk Control Practices on the Profitability of Telecommunication Companies in Garowe, Somalia

Indicator	Mean
Credit Risk Controls practices	
Imposing loan size limits is a viable strategy in credit management	3.85
The use of credit checks on regular basis enhances credit management	3.96
Flexible repayment periods improve loan repayment	3.94
Penalty for late payment enhances customer’s commitment to pay bills on time.	3.60
The use of customer application forms improves monitoring and credit management as well	3.83
Average mean	**3.83**

In view of the results in table 2 above, The study established that credit checks on regular basis enhances organization performance, Imposing loan size limits is a viable strategy in credit management affect performance of Telecommunication companies, the use of customer credit application forms improves monitoring and credit management as well, penalty for late payment enhances customers commitment to loan repayment, flexible repayment periods improve loan repayment and credit committees involvement in making decisions regarding credit risk controls are essential in reducing default/credit risk. Essential credit controls used include loan product design, delinquency management and credit committees (Churchill & Coster, 2011).

According to Gregoriou and Hoppe (2009) bank loan is a debt, which entails the redistribution of the financial assets between the lender and the borrower. The bank loan is commonly referred to the borrower who got an amount of money from the lender, and need to pay back, known as the principal. In addition, the banks normally charge a fee from the borrower, which is the interest on the debt. The risk associated with loans is credit risk.

Effect of Collection Policy Practices on the profitability of Telecommunication Companies in Garowe, Somalia

This objective sought to examine the effect of Collection Policy Practices on the profitability of telecommunication companies in Garowe, Somalia. Based on a five-point Likert scale (Strongly Disagree, Disagree, Neutral, Agree, and Strongly Agree), respondents were presented several items to measure the extent to which Collection Policy Practices effect the profitability of telecommunication companies in Garowe, Somalia. Table 3 shows Effect of Collection Policy Practices on the profitability of telecommunication companies in Garowe, Somalia**.**

Table 3: Influence of Collection Policy Practices on the profitability of telecommunication Companies in Garowe, Somalia

Indicator	Mean
Collection Policy Practices	
Collection policies formulation have been a challenge in credit management	3.96
Availability of collection policies have helped towards effective credit management	4.14
implementation of guarantee policies provides chances for loan recovery in case of loan defaults	4.49
Staff incentives are useful in improving recovery of prolonged loans	3.75
Regular reviews have been done on collection policies to enhance means of credit management.	3.68
A strict policy is more effective in debt recovery than a soft policy	3.76
Average mean	**3.9**

The results tabulated in Table 3 shows that the respondents strongly agreed that companies made great use of collection policy practices to manage the credit as shown by high means of 4.49.This kind of policy is important for those who might not be in a hurry to make their payments on time or those who have a history of not paying (Stiglitz & Weiss, 1981). Therefore, such efforts quicken the payments from slow payers and reduce the bad debts. Payments when made in time increase cash flow and keep the bad debts at manageable levels. However, the policy should not have extreme practices especially to loyal customers as they might seek alternatives (Padilla & Pagano, 2000).

Regression Analysis Results

Table 4: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.990[a]	.981	.981	.16286

Predictors: (Constant), Client Appraisal, Credit Risk Control and Collection Policy

R-squared is a statistical measure of how close the data are to the fitted regression line. It is also known as the coefficient of determination, or the coefficient of multiple determinations for multiple regressions. 0% indicates that the model explains none of the Variability of the response data around its mean. The adjusted R-squared is a modified version of R-squared that has been adjusted for the number of predictors in the model. The adjusted R-squared increases only if the new term improves the model more than would be expected by chance. It decreases when a predictor improves the model by less than expected by chance.

The model summary of the regression analysis in Table 4 shows that credit management practices accounted for 98.1 % of the variance in the profitability of telecommunication companies in Garowe, Somalia (R square = 0.981). This shows that 1.9% of the variance in growth was explained by factors not in the study.

Table 5: ANOVA

	Sum of Squares	Df	Mean Square	F	Sig.
Regression	210.032	3	52.508	1979.664	.000[b]
Residual	4.058	53	.027		
Total	214.090	57			

The analysis of variance ANOVA is used to determine whether the model overall is a good fit. From the ANOVA statistics, the processed data (population parameters) had a significance level of 0.000. This shows that the data is ideal for making conclusions on the population's parameter as the p-value is less than the significance level of 0.05.

In view of the results in table 5 above, The F calculated was greater than F critical 1979.664>2.431. This shows that project top client appraisal, credit risk control, collection policy significantly influences profitability of telecommunication industries.

Table 6 Coefficients

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.257	.060	4.257	.000	.257
Client Appraisal	.062	.054	.064	1.147	.253
Credit Risk Control	.514	.095	.491	5.398	.000
Collection Policy	.219	.091	.192	2.414	.017

The regression equation was extracted from table above is as follows:

Y = 0.257+ 0.062 X1 + 0.514X2 + 0.219 X3

In view of the results in table above, Client appraisal is statistically significant in explaining financial performance of telecommunication companies as shown by (β = 0.062). This shows that client appraisal had significant positive relationship with profitability of the telecommunication companies. This is an indication that a unit increase in client appraisal will result to an increase in financial performance of the telecommunication companies. Credit risk control is statistically significant in explaining financial performance of telecommunication companies

As shown by (β = 0.514). This shows that credit risk control had significant positive relationship with financial performance of telecommunication companies. This implies that a unit increase in credit risk control will result to an increase in financial performance of the telecommunication companies. In addition, Collection Policy is statistically significant in explaining financial performance of telecommunication companies as shown by (β = 0.219). This shows that Collection Policy had significant positive relationship with financial performance of the telecommunication companies. This implies that a unit increase in Collection Policy will result to an increase in financial performance of the telecommunication companies.

The statistical significance of the independent variables in explaining financial performance is captured throughout the p-values. Collection policy is statistically significant in explaining financial performance of telecommunication companies as indicated by (P = 0.017). This is an indication that collection policy has a significant and positive effect on financial performance of the telecommunication companies studied. In addition, terms of credit have a statistically significant effect in explaining financial performance of telecommunication companies as shown by P = 0.000). (Client Appraisal is statistically significant in explaining financial performance of telecommunication companies as indicated by (P = 0. 253); this suggests that client appraisal has a significant and positive effect on financial performance of the telecommunication companies. Credit Risk Control is statistically significant in explaining financial performance of telecommunication companies as indicated by (P = 0.000); this indicates that it has a positive and significant effect on financial performance of the telecommunication companies Consequently, with respect to hypothesis testing, the study supports the null hypothesis that Client appraisal does not have a significant effect on financial performance of telecommunication companies in Garowe, Somalia while it rejects the rest of the null hypotheses that Credit risk control, Collection policy do not have a significant effect of profitability of telecommunication companies in Garowe Somalia.

Discussions on Regression Analysis

The first step in limiting credit risk involves screening clients to ensure that they have the willingness and ability to repay a loan, which has positive effect on profitability (Abedi, 2000), this is contrary with the findings of this research.

The results from regression analysis on this study revealed that credit risk control contributes to the profitability of telecommunication companies in Garowe, Somalia, this consistent with findings of Waymond,(2007) which found out that; One of the principal duties of financial institutions is to provide loans, this is typically the source of income to banks, bank loans and credit also constitute one of the ways of increasing money supply in the economy.

The collection effort should, therefore aim at accelerating collections from slow payers and reducing bad debt losses (Kariuki, 2010), this results matches the findings of this research which revealed that collection reduces loss which means increase of profitability of telecommunication companies in Garowe, Somalia.

Summary of the findings

This part presents the summarized results and interpretation (findings) based on the study objectives as established at the beginning of the study.

Effects of Client Appraisal on Profitability

This study was to find out the influence of client assessment on profitability of Telecommunication Companies in Garowe, Puntland, Somalia. This study realized that the client appraisal plays a major role for credit management of the companies. The study also found out that the companies have highly skilled manpower to do client assessment before they are given loans.

The clients' character and capacity to post pay the bills (4.67 very good), (3.72 good) respectively are assessed in telecommunication companies as table 4.3.2 shows. The table also shows that loan defaults are caused by failure to evaluate client's ability to pay bills after use. Collateral is greatly considered while evaluating clients as majority of respondents agreed (3.9 good) and it's indicated by table 4.6.

Client appraisal effects profitability of the telecommunication companies in Garowe, as implied by responses from respondents in the table 4.6

Effects of Credit Risk Control on Profitability

The study was to establish the influence of credit risk management on profitability of telecommunication companies in Garowe, Puntland Somalia. The table 4.7 shows that credit checks on regular basis enhances organization profitability, Imposing loan size limits is a viable strategy in credit management affect performance of Telecommunication companies, the use of customer Credit application forms improves monitoring and credit management as well, penalty for late payment enhances customers commitment to loan repayment, flexible repayment periods improve loan repayment and credit committees involvement in making decisions regarding credit risk controls are essential in reducing default/credit risk.

Effects of Collection Policy on Profitability

This study sought to investigate the influence of the collection policy practices on profitability on telecommunication companies in Garowe, Puntland, Somalia. The study revealed that companies implement their respective collection policies and it has effect on profitability of the telecommunication companies.

The results tabulated in Table 4.8 shows that the respondents strongly agreed that companies made great use of collection policy practices to manage the credit as shown by high means of 4.49 and 3.75 respectively.

This kind of policy is important for those who might not be in a hurry to make their payments on time or those who have a history of not paying (Stiglitz & Weiss, 1981). Therefore, such efforts quicken the payments from slow payers and reduce the bad debts. Payments when made in time increase cash flow and keep the bad debts at manageable levels. However, the policy should not have extreme practices especially to loyal customers as they might seek alternatives (Padilla & Pagano, 2000).

Conclusion

According to the findings of the topic “Effects of Credit Management Practices on Profitability of Telecommunication Companies in Garowe, Somalia” the client appraisal has a positive relationship with profitability of the Telecommunication Companies in Garowe Puntland, Somalia. The study also revealed that client assessments are done by Telecommunication Companies.

It is also worth to mention that Telecommunication companies give credit services (Internet, electricity and Telephone Airtime) to the customers. These services are either postpaid or prepaid, so the study focused postpaid services provided by telecommunication companies in Garowe, Somalia, and how this credit is managed and its implications on the profitability of the companies.

The study found out that Credit risk control positively effects on profitability of the telecommunication companies. Limiting the usage of services reduces credit risk according to finding of this study. Clients fill forms before the provision of credit services as findings revealed; this reduces credit risk and enhances profitability of the telecommunication companies.

The Companies have credit committees which evaluate clients filled forms before approval of the credit, they also use flexible repayment periods which improved credit risk control; this however implies that Credit control has also positive relationship with profitability of the telecommunication companies.

The study concludes that collection policy has a significant positive relationship with profitability of the telecommunication companies in Garowe Puntland Somalia. This policy helped companies for quick payments of the credit, as most clients respect companies’ terms and conditions.

Recommendations

The study purposes telecommunication companies in Garowe, to create profile assessment data base to ease client appraisal and collection policies as well, this will improve their profitability.

The study also recommends telecommunication companies to soften their strict credit collection policies to retain their loyal clients, which in turn will increase their performance in the long run.

The study recommends telecommunication companies to reduce the bitter competition among them, because it can decrease their financial performance and country's economic growth in general.

The study also recommends that Puntland Government, particularly the Ministry of Information, Telecommunication, Culture and Heritage should issue related policies, which favors end users of the credit services provided by telecommunication companies in Garowe, Somalia.

Apart from the findings of this research, the study recommends that Telecommunications companies to increase female employees since they are male dominated enterprises. The study also recommends telecommunication companies in Garowe, Somalia to hire more educated youth to reduce illegal migration of youth.

Suggestions for Further Research

The study would further recommend conducting other studies for the following areas.

1. The Effects of Credit Management Practices on Customer loyalty of Telecommunication companies in Garowe, Puntland, Somalia

2. Factors affecting financial performance of Telecommunication companies in Garowe, Puntland, Somalia

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